Economic Commentary

TrustINdiana

Market Commentary for **December 2008**

Economy Continues to Worsen

The end of the year was not kind to the U.S. economy. The financial markets continue to be volatile, despite the winding down of the first $350 billion allocated for the Wall Street rescue package. The incoming Obama administration is working with the newly sworn-in Congress on a gigantic economic stimulus plan that will total anywhere from $750 billion to $1.25 trillion. It is likely to include at least $300 billion in tax cuts and massive spending on infrastructure as well as housing relief. The actual details of the plan have not yet been agreed upon. It was initially hoped that President-elect Barack Obama would sign the stimulus legislation on his first day in office, but it is now thought that it will not get through the Senate until mid to late February.

Third quarter gross domestic product (GDP) contracted 0.5 percent and it is estimated to dip as low as -4.5 to -5.0 percent for the fourth quarter of 2008 according to Moody's. Official advance figures with regard to GDP will not be released by the Bureau of Economic Analysis until the end of January. If the estimate is correct, this will mean that the U.S. economy will meet the classic criterion of recession, which is two consecutive quarters of negative GDP growth. However, according to the National Bureau of Economic Research, which is frequently referred to as the arbiter of the national business cycle, and looks at other indicators beyond GDP when assessing the health of the economy, we have been in recession since December 2007 --one which has affected nearly every sector of the economy.

The December unemployment rate rose to 7.2 percent, the highest level since the early 1990s. This is up from 6.8 percent in November. The unemployment rate has jumped 2.3 percentage points since December of 2007. This puts the total number of unemployed labor force participants who are actively seeking jobs at 11.1 million. Job losses were fairly broad-based but felt most sharply in the manufacturing, business services, and retail sectors.

The consumer continues to have a bleak outlook, although the University of Michigan Consumer Sentiment Index edged up in December over the previous month, climbing to 60.1 from 55.3. This rise is slightly misleading, however. The index tracks consumers' perceptions of present conditions and expectations for the future. The outlook for present conditions jumped nearly ten points in December because of the erosion of inflationary fears and the depression of prices across the board, especially those of fuel. The expectations component of the index remained at a near historic low of 54.0. Personal income dropped 0.2 percent in November, but, according to the Consumer Price Index, prices dropped 1.7 percent to more than make up for the shortfall. Thus while spending fell 0.6 percent from the previous month, real spending, which takes into account the fall in prices, actually increased by 0.6 percent.

The housing market remains in the doldrums. Existing home sales were down 8.6 percent in November, the largest monthly decline in this cycle, to an annualized rate of 4.49 million units. New home sales fell 3 percent for the month of November and 35 percent year-over-year. The median sales price for a new home is down 11 percent for the year.

As the consumer goes, so goes business. Corporate profits fell $18.5 billion in the third quarter revised downward from a loss of $14.6 billion in a preliminary report, making for a 9.0 percent plunge on a year-over-year basis. This marks the fifth straight quarter of a decrease in profits, a phenomenon not seen in 40 years. Durable goods orders fell 1.0 percent in November, which, while not a positive development, was significantly better than the 8.4 percent plummet in October. November would have actually seen a modest rise in orders if transportation equipment was excluded from the mix. Predictably, aircraft and auto-related orders were the primary drags on this figure. The Institute for Supply Management (ISM) manufacturing index, which attempts to measure the overall health of U.S. manufacturing, slid a further 3.8 points to 32.4 for December, marking the lowest level for the index since 1980. Retail sales (MARTS) were down 1.8 percent for November, which is slightly better than the 2.9 percent contraction seen in October. The November decline was led by the slump in sales at gas stations and auto dealers. On a year-over-year basis, retail sales have fallen at the fastest rate since tracking began in the 1960s.

The Federal Open Market Committee (FOMC) met on December 16 and lowered the fed funds target rate to between 0 and 0.25 percent from 1 percent. This is the lowest level in history. The Committee released a statement, "Since the Committee's last meeting, labor market conditions have deteriorated, and the available data indicate that consumer spending, business investment, and industrial production have declined... The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability." The statement also noted that it intends to keep the rate low for the foreseeable future and that inflationary fears have all but disappeared.

Sector Review

U.S. Treasuries: Continued deterioration of the economy and the struggling financial sector made Treasuries more attractive to investors than other risk assets. The 10-year note yield dropped to a 2.92 percent yield from a 3.96 percent yield the prior month. The two-year note yield decreased to a 0.76 percent yield from a 0.98 percent yield while the three-month bill saw yields remain at or near 0.01 percent. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase).

Commercial Paper: The Federal Reserve's Commercial Paper Funding Facility (CPFF) helped ease year-end concerns. This program allowed the Fed to buy top-tier asset-back commercial paper (ABCP) and unsecured commercial paper (CP) from the market over the last two months, which has amounted to $322 million. Overall, the commercial paper supply increased slightly on a seasonally adjusted basis by $56 billion. One-month, top-tier, higher quality ABCP names traded between 0.25 percent and 1.75 percent, and three-month paper traded between 0.40 percent and 2.00 percent.

U.S. Government Agencies: Agencies continued to attract investors who were fleeing from other riskier assets. The Fed also began to buy more agency securities onto its balance sheet throughout the month which helped improve the interest for Freddie Mac and Fannie Mae's debt instruments. This move is designed to further assist the stabilization of the financial markets given the current economically challenged times. Agency yields at month-end on three-month paper yielded near 0.15 percent, six-month paper yielded 0.40 percent, and 12-month paper yielded 0.80 percent.

Strategy: In a historic announcement, the Fed cut the fed funds target range to between 0.00 percent and 0.25 percent. The continued deterioration of labor market conditions and the decline in consumer spending, business investment, and industrial production also were noted in the Fed's statement while inflation pressures moderated as energy prices dropped precipitously and left space for such an action. The Fed also noted that the fed funds rate could remain at the current levels for some time given its expectations for continued weak economic conditions in the coming quarters. We have implemented a defensive strategy that maintains ample cash as we selectively identify trade opportunities that add yield in the longer part of the money market curve.

DJIA		NASDAQ		S&P 500	
-0.59%	-33.83%	2.70%	-40.54%	7.82%	-38.48%
Month	Year-to-Date	Month	Year-to-Date	Month	Year-to-Date

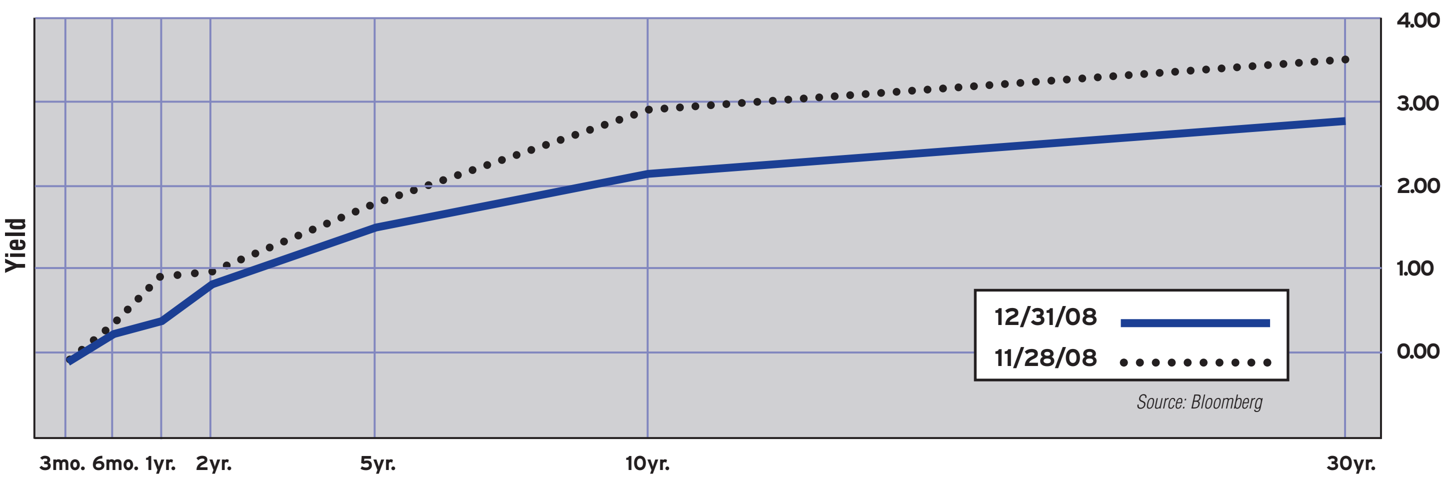
The opinions expressed above are those of TrustINdiana and are subject to change without notice. All statistics represent month-end figures unless otherwise noted.

Market Summary for **December 2008**

Monthly Market Summary - Week-ending Rates and Yields

	12/05	12/12	12/19	12/26	4th QTR AVG	3rd QTR AVG	2nd QTR AVG	1st QTR AVG
Overnight Rates								
Effective Fed Funds	0.12	0.15	0.11	0.09	0.45	1.90	2.07	3.19
Repurchase Agreements	0.05	0.10	0.05	0.05	0.20	1.89	2.02	2.67
Discount Rates								
1 Month Treasury Bill	0.01	0.01	0.04	0.05	0.11	1.33	1.42	2.00
1 Month Agency Disc.	0.15	0.02	0.08	0.15	0.52	2.21	2.06	2.80
1 Month Com'l Paper	1.30	0.68	0.33	0.31	1.83	2.49	2.45	3.18
3 Month Treasury Bill	0.02	0.03	0.00	0.01	0.27	1.49	1.61	2.00
3 Month Agency Disc.	0.55	0.09	0.18	0.28	1.11	2.42	2.16	2.77
3 Month Com'l Paper	2.10	1.76	0.77	0.46	2.48	2.81	2.67	3.11
6 Month Treasury Bill	0.18	0.17	0.10	0.17	0.62	1.78	1.82	2.07
6 Month Agency Disc.	0.82	0.32	0.30	0.44	1.55	2.69	2.25	2.64
6 Month Com'l Paper	2.46	1.96	1.39	0.73	2.67	3.08	2.78	3.01
Yields								
1 Year Treasury	0.54	0.50	0.44	0.38	0.98	2.16	2.07	2.07
1 Year Agency	1.64	1.02	0.74	0.71	2.14	2.91	2.68	2.58
2 Year Treasury	0.93	0.76	0.74	0.89	1.22	2.40	2.40	1.97
2 Year Agency	2.41	1.99	1.67	1.52	2.62	3.22	3.03	2.60
5 Year Treasury	1.70	1.51	1.36	1.52	2.20	3.13	3.15	2.70
5 Year Agency	2.83	2.57	2.36	2.44	3.51	4.09	3.88	3.45

Historical Yield Curve



Key Economic Indicators

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	December	01/09	7.0%	7.2%	6.8%
Consumer Price Index	November	12/16	1.5%	1.1%	3.7%
- Less Food and Energy	November	12/16	2.1%	2.0%	2.2%
Consumer Conf. (CB)	December	12/30	45.5	38.0	44.9
FOMC Rate Decision		12/16	0.50%	0.25%	1.00%
Gross Domestic Product	3QF	12/23	-0.5%	-0.5%	-0.5%

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